



# ***PR 2002/12 - Income tax: Sandalwood and Mango Project 2002***

 This cover sheet is provided for information only. It does not form part of *PR 2002/12 - Income tax: Sandalwood and Mango Project 2002*

 This document has changed over time. This is a consolidated version of the ruling which was published on *6 February 2002*



## Product Ruling

### Income tax: Sandalwood and Mango Project 2002

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Previous Ruling	14
Arrangement	15
Ruling	45
Explanations	74
Examples	124
Detailed contents list	127

Potential participants may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

#### *Preamble*

*The number, subject heading, and the **What this Product Ruling is about** (Including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Previous Rulings**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

### No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out below in the **Ruling** part of this document are available **provided that** the arrangement is carried out in accordance with the information we have been given and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

### Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

## What this Product Ruling is about

---

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the 'Sandalwood and Mango Project 2002', or just simply as 'the Project'.

### Tax laws

2. The tax laws dealt with in this Ruling are:
- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - Section 8-1 (ITAA 1997);
  - Section 17-5 (ITAA 1997);
  - Division 27 (ITAA 1997);
  - Division 35 (ITAA 1997);
  - Division 40 (ITAA 1997);
  - Part 2-25 (ITAA 1997);
  - Division 328 (ITAA 1997);
  - Section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - Section 82KZL (ITAA 1936);
  - sections 82KZME - 82KZMF (ITAA 1936); and
  - Part IVA (ITAA 1936).

### Goods and Services Tax

3. All fees and expenditure referred to in this Ruling include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a 'Grower') to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

### Changes in the Law

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and

continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

### **Note to promoters and advisers**

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

### **Class of persons**

7. The class of persons to whom this Ruling applies is those who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

### **Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior

written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

## Date of effect

---

11. This Ruling applies prospectively from 6 February 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

---

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## Previous Ruling

---

14. This Ruling is based on a similar arrangement to the Project that was ruled upon in Product Ruling PR 2001/79. Product Ruling PR 2001/79 is now withdrawn on and from the date this Ruling is made. The Project that is the subject of PR 2001/79 has not commenced and as such there is no class of persons to whom that Ruling applies.

---

## Arrangement

---

15. The arrangement that is the subject of this Ruling is described below. This arrangement incorporates the following documents:

- Applications for Product Ruling dated 13 February 2001 and 30 November 2001;
- Draft Prospectus to be issued by Kimberley Plantations Ltd ('Responsible Entity'), undated, received 4 December 2001;
- Draft Constitution for the Sandalwood and Mango Project, undated, received 13 February 2001;
- Draft **Management Agreement** between Kimberley Plantations Management Pty Ltd (the 'Manager') and the Grower, undated, received 4 December 2001;
- Draft **Sub-Lease Agreement** between Kimberley Plantations Holdings Pty Ltd (the 'Lessee') and the Grower, undated, received 4 December 2001;
- Draft Compliance Plan for the Sandalwood and Mango Project, undated, received 14 May 2001; and
- Additional correspondence from the Applicant dated 4 April 2001, 10 May 2001, 14 May 2001, 22 May 2001 and 30 January 2002.

**Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.**

16. The documents highlighted are those that Growers may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

## Overview

17. This arrangement is called the Sandalwood and Mango Project 2002. The salient features are as follows:

**PR 2002/12**

Location	Kununurra, Western Australia
Type of business each participant is carrying on	Commercial growing, and cultivation of: <ul style="list-style-type: none"> <li>Indian Sandalwood (<i>Santalum album</i>) trees for the purpose of harvesting and selling the timber;</li> <li>Mangoes for the purpose of harvesting and selling fruit.</li> </ul>
Number of hectares offered for cultivation	180 hectares (1,600 Woodlots)
Size of each Woodlot	0.1125 hectares comprising 625m <sup>2</sup> for Sandalwood and 500m <sup>2</sup> for Mangoes
Minimum allocation	1 Woodlot
Minimum subscription	600 Woodlots
Number of trees established per hectare	Sandalwood – 640; Mango - 200
Expected production	Sandalwood - 22,400 kg per hectare; Mangoes - commencing at 3,000 kg per hectare in year 3, increasing to 22,500 kg per hectare in year 8.
The term of the Project	Approximately 15 years
Initial cost	\$5,500
Initial cost per hectare	\$48,888
Ongoing and other costs	Sub-Lease and Management Fees payable annually and additional fees payable from harvest proceeds.

18. The Project will be registered as a Managed Investment Scheme under the Corporations Act. The Responsible Entity for this Project is Kimberley Plantations Ltd ('KPL'). The Project will be conducted near the Ord River in Kununurra, Western Australia, on land described as:

- (a) King Location 383 being part of the land contained in Certificate of Title Volume 1934 Folio 896.

19. Growers participating in the arrangement will enter into a Sub-Lease Agreement. Under this agreement, Growers lease an area of land called a 'Woodlot' for a term of approximately 15 years. The project land will be divided into two distinct areas for growing Indian Sandalwood and Mangoes. Each Woodlot will consist of two areas totalling 0.1125 hectares. Overall, it is proposed to plant

1,600 Woodlots. These Woodlots are separately identified in a plan of the Plantation.

20. There is a minimum subscription of 600 Woodlots for this Project. Under this offer, Growers may enter the Project in either the 2001/2002 income year (defined as '2002 Growers' for the purposes of this Ruling) or the 2002/2003 income year ('2003 Growers'). Applications to become 2002 Growers must initially be received by 31 May 2002. The Responsible Entity may accept late applications for 2002 Growers but only where it can complete establishment services by 30 June 2002, such date for acceptance being no later than 15 June 2002. Applications received after that date will be executed on or after 1 July 2002 and will commence participation in the Project as '2003 Growers'.

21. The Growers will also enter into an agreement with the Manager for the management of their Woodlot. The Manager will be responsible for establishing and cultivating the trees and harvesting, processing and selling the produce. Growers may elect to harvest and sell their own produce or the Manager will do so on their behalf.

22. Harvesting of the Indian Sandalwood will take place towards the end of the Project and is expected to be completed in the final year of the Term. The Mango is an annual crop and will be harvested each year commencing in the year ending 30 June 2005. Yields will increase as the Mango trees mature.

### **Constitution**

23. The Constitution establishes the Project and operates as a deed binding on all of the Members (Growers) of the scheme and the Responsible Entity. The Constitution sets out the terms and conditions under which KPL agrees to act as Responsible Entity and thereby manage the Project. The Sub-Lease and the Management Agreement will be executed on behalf of a Grower following them signing the Application Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project.

24. The Responsible Entity will:

- prepare the Sub-Lease Agreement and Management Agreement (clause 13.5);
- ensure that application moneys are not released until the appropriate agreements are in place (clause 14);
- keep a register of Growers (clause 16); and
- distribute profits (clause 12.4).



## **Compliance plan**

25. KPL has prepared a Compliance Plan as required by the Corporations Act. Its purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

## **Head Lease**

26. The owner of the land has agreed to lease an area of land to Kimberley Plantations Holdings Pty Ltd (the 'Lessee') in order to conduct the Project. The Lessee is entitled to use the land for the establishment of a Sandalwood and Mango plantation and to sub-lease the land in Woodlots for the purpose of a Managed Investment Scheme. The Head Lease Agreement is subject to the Responsible Entity achieving minimum subscription under the Prospectus and obtaining approvals for the land to be used as a tree plantation.

## **Interest in Land**

27. Growers participating in the arrangement will enter into a Sub-Lease Agreement between Kimberley Plantations Holdings Pty Ltd as 'Lessee' and the Grower as a 'Sub-Lessee'. Growers are granted an interest to use their Woodlot for the purpose of cultivating and harvesting trees. The term of the sub-lease is until the final distribution of the sales proceeds is made in approximately 15 years, or until the Project is terminated, if earlier.

28. Each Grower must pay rent to the Lessee during the Term of the Project in an amount specified in Clause 5 of the Sub-Lease Agreement.

## **Management Agreement**

29. Each Grower will enter into a Management Agreement with Kimberley Plantations Management Pty Ltd ('KPM'). KPM will be appointed the Manager of the Project to perform services under the Management Agreement. The appointment of the Manager is for the purpose of overseeing the management of the scheme and to provide management services for the establishment of the plantation, nurturing of the crops situated on the Woodlot and the eventual harvest and sale of the produce. Clause 3 of the agreement specifies the services to be performed by the Manager. The Manager will supervise and manage all horticultural and forestry activities on behalf of the Grower and must:

- conduct land preparation and construct and establish an irrigation system on each Woodlot;
- supply and plant seedlings and replace any seedlings that fail to establish within twelve months of planting;
- supply adequate water and provide general care and maintenance in accordance with good agro-forestry practice; and
- maintain and ensure the continued operation of the irrigation system, access roads, firebreaks and pest and weed control programme.

30. The Manager shall be entitled to remuneration for the performance of its duties under the Management Agreement. \$5,307.50 is payable to the Manager on Application. Annual fees are also payable under the agreement.

### **Fees**

31. The fees payable under the Management Agreement and the Sub-Lease Agreement on a per Woodlot basis are as follows:

- Management Fee of \$3,850 payable to the Manager on Application for the period from the Commencement Date to 30 June in the financial year in which the Commencement Date falls (defined as the 'Initial Period');
- Irrigation fee of \$742.50 payable to the Manager on Application for the costs of supplying and installing an irrigation system on the Woodlot in the Initial Period;
- A fee of \$220 payable to the Manager on Application for the cost of supplying Mango trees in the Initial Period;
- Planting fee of \$495 payable to the Manager on Application for planting Sandalwood seedlings and Mango trees by 30 September in the year following the Initial Period;
- Management Fee of \$962.50 for the second year, (being the financial year after the Initial Period), payable to the Manager within 14 days of the Manager's invoice which shall be rendered on the first anniversary of the Commencement Date;
- In each subsequent year, a Management Fee is payable to the Manager within 14 days of the Manager's invoice which shall be rendered on each anniversary of

the Commencement Date during the Term. The amount will be the fee in the preceding year indexed at the greater of 3% per annum or the annual rate of inflation;

- Rent of \$192.50 payable to the Lessee on Application for the first year (being 12 months commencing from the Commencement Date);
- Rent of \$192.50 for the second year, (being 12 months commencing on the first anniversary of the Commencement Date), payable to the Lessee within 14 days of the Lessee's invoice which shall be rendered within 90 days of the first anniversary of the Commencement Date; and
- In each subsequent year, Rent is payable to the Lessee within 14 days of the Lessee's invoice which shall be rendered within 90 days of each anniversary of the Commencement Date during the Term. The amount will be the Rent in the preceding year indexed at the greater of 3% per annum or the annual rate of inflation.

32. Non-Electing Growers (see paragraph 37) are also required to pay to the Manager an amount equal to 5.5% of the Gross Sales Proceeds for additional management and administration costs associated with harvesting and marketing (clause 6.2).

33. The Manager will endeavour to, if so requested, arrange insurance for the Grower's Woodlot on behalf of the Grower. The cost of such insurance will be at the expense of the Grower (clause 3.6).

34. Under the terms of the Constitution, all moneys received from Applications shall be paid to the Responsible Entity. The Responsible Entity shall deposit those moneys into an Application Account in the name of the Responsible Entity. The Application Money will be released by the Responsible Entity when it is reasonably satisfied that certain specified criteria in the Constitution have been met (clause 11 of the Constitution).

## Planting

35. Under the Management Agreement, the Manager will supply the necessary seedlings and host trees. The Manager will be responsible for planting the seedlings on the Woodlots by 30 September 2002 for 2002 Growers and by 30 September 2003 for 2003 Growers. Each Woodlot will be planted with Indian Sandalwood seedlings at a rate of 640 trees per hectare and Mango trees at a rate of 200 trees per hectare. The Manager will replace any seedlings that fail

to establish within twelve months of planting. The Manager will then maintain the trees in accordance with good agro-forestry practice. The services to be provided by the Manager over the term of the Project are outlined in clause 3 of the Management Agreement.

### **Harvesting and Sale**

36. The Grower has full right, title and interest in the Crop and Produce at all times and the right to have the Produce sold for their benefit.

37. Growers may elect to harvest and sell their own Produce by replying to a Harvest Notice issued by the Manager when the Crop is ready to be harvested (defined as an 'Electing Grower' under clause 6.1 of the Management Agreement), or the Manager will harvest and sell the Produce on their behalf ('Non-Electing Grower') for the highest possible price (clause 6 of the Management Agreement).

38. The Mango trees will produce an annual crop and will be harvested every year commencing during the year ending 30 June 2005. The Indian Sandalwood is expected to be harvested at the end of the Project in the year ending 30 June 2017 (2002 Growers) or 30 June 2018 (2003 Growers) but will take place as and when deemed appropriate by the Manager in producing the best overall result for the Grower.

39. A Harvest Notice will be issued by the Manager at the time determined that the Crop is ready to be harvested. Unless the Grower elects to harvest and sell their own Produce, the Manager will be responsible for arranging the marketing and sale of the Produce. The Manager is only required to send a Harvest Notice for the first Mango harvest and the election shall stand for the remainder of the Project unless revoked in writing by the Grower.

40. Electing Growers must notify the Manager in writing within 30 days of the anticipated time that the Grower intends to harvest its Crop, which must be prior to the expiration of the Term. All outstanding management fees, charges and expenses entitled to be deducted from sales proceeds must be accounted to the Manager on or before the date the Electing Grower harvests its Woodlot.

41. The proceeds from sale of the Non-Electing Growers produce will be paid direct to the Responsible Entity who must deposit them into a Sales Proceeds Account. The Responsible Entity may deduct any amounts owing by a Grower under the Sub-Lease Agreement or Management Agreement. Growers will then be distributed the appropriate amount based on their proportionate interest in the Project less any authorised deductions.

42. Growers will share the sales proceeds on a proportionate basis, following the payment of harvest costs and any amounts due and payable by the relevant Grower.

## **Finance**

43. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

44. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved in the provision of finance for the Project;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' will be granted to the borrowers for the purpose of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan terms or rate of interest are of a non-arm's length nature;
- repayments of the principal and interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism) back to the lender or any associate; or
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers.

## **Ruling**

---

### **Application of this Ruling**

45. This Ruling applies only to Growers who are accepted to participate in the Project:

- before 15 June 2002, where the Grower has executed a Sub-Lease Agreement and a Management Agreement on or before that date (2002 Growers); and/or
- on or after 1 July 2002 and before the Prospectus expires, but in any case, before 15 June 2003 and where the Grower has executed a Sub-Lease Agreement and a Management Agreement on or between those dates (2003 Growers).

46. The Grower's participation in the Project must constitute the carrying on of a business of primary production. For 2002 Growers, references in the following paragraphs to the Initial Period, Year 2 and Year 3 are references to the income years ending 30 June 2002, 30 June 2003 and 30 June 2004 respectively. For 2003 Growers, references to the Initial Period, Year 2 and Year 3 are references to the income years ended 30 June 2003, 30 June 2004 and 30 June 2005 respectively.

### **Minimum subscription**

47. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the project is accepted and the Project has commenced. Under the terms of the Prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 600 Woodlots is achieved.

### **The Simplified Tax System ('STS')**

#### **Division 328**

48. For a Grower who is accepted into this Project, the recognition of income and the timing of tax deductions will depend upon whether, in an income year(s), the Grower is an 'STS taxpayer' or is not an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

### **Qualification**

49. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer' during the term of the Project. These are contingencies, relating to the circumstances of individual Growers that

cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

### **Prepaid fees**

50. Planting fees and lease fees incurred by Growers who are accepted into this Project are subject to the prepayment rules in sections 82KZME and 82KZMF. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred. Where a Grower prepays expenditure that would otherwise be a general deduction under section 8-1 of the ITAA 1997 in the expenditure year, the Grower must apportion the prepayment over the period the prepayment covers unless it is 'excluded expenditure' (see Notes (ii) & (iii) at paragraph 57 below).

51. Subsection 82KZMF(1) provides the formula for determining how much of the prepaid expenditure a Grower can deduct for each income year. In that formula, which is shown below, the 'eligible service period' means the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

52. In this Project, the tax deductions allowable for lease fees and management fees associated with Planting services, must be calculated by applying the above formula to the amount incurred each year by the Grower. The resulting tax deductions are reflected in the respective Tables of deductions shown below.

### **Tax outcomes for Growers who are not 'STS taxpayers'**

#### **Assessable Income**

##### ***Section 6-5***

53. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

54. The Grower recognises ordinary income from carrying on the business of agro-forestry at the time that income is derived.

**Trading Stock*****Section 70-35***

55. A Grower who is not an 'STS taxpayer' may, in some years, hold mangoes that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock on hand at the *start* of an income year a Grower must include the amount of that excess in assessable income.

56. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

**Deductions for Management fees and Lease fees*****Section 8-1***

57. A Grower who is not an 'STS taxpayer' may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the following Tables. Deductions will be available for 2002 Growers and 2003 Growers in accordance with the year in which the Grower commences participation in the Project.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Initial Period</b>	<b>Year 2</b>	<b>Year 3</b>
<b>Management Fees</b>	8-1	\$3,850  See note (i) below	\$962.50  See notes (i) & (ii) below	\$962.50 (indexed) See notes (i), (ii) & (iv) below
<b>Planting</b>	8-1	See notes (i) & (v) below	See notes (i) & (v) below	
<b>Sub-Lease Fee (Rent)</b>	8-1	See notes (i) & (iii) below	See notes (i) & (iii) below	See notes (i), (iii) & (iv) below

**Notes:**

- (i) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 124;
- (ii) The Management fees shown in the Management Agreement are deductible in full in the year that they



are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **must** be determined using the formula shown in paragraph 51 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is not an 'STS taxpayer', is deductible in full in the year in which it is incurred (see Example 3 at paragraph 126). For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000;

- (iii) Although the Sub-Lease Agreement requires the lease fee to be prepaid, for a Grower who acquires the minimum allocation of one Woodlot, the amount of the prepaid lease fee is less than \$1,000 and will be deductible as 'excluded expenditure'. However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid lease fee may be \$1,000 or more. Such Growers **must** determine the deduction for the prepaid lease fee using the formula shown above at paragraph 51;
- (iv) Sub-Lease and management fees are subject to indexation. The amount will be the prior year fee indexed at 3% or the annual rate of inflation, whichever is greater;
- (v) Although the Management Agreement requires the Planting fee to be prepaid, for a Grower who acquires either one or two Woodlots, the amount of the prepaid fee is less than \$1,000 and will be deductible as 'excluded expenditure'. However, where a Grower acquires three or more Woodlots, the amount of the tax deduction for the Grower's prepaid Planting fee **must** be determined using the formula shown above at paragraph 51.

## **Deductions for capital expenditure**

### ***Division 40***

58. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (irrigation) and the establishment of mango trees. Deductions will be available for 2002

Growers and 2003 Growers in accordance with the year in which the Grower commences participation in the Project. The deductions shown below are determined under Division 40.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Initial Period</b>	<b>Year 2</b>	<b>Year 3</b>
<b>Irrigation</b>	40-515	\$247 see notes (vi) & (vii) below	\$247 see notes (vi) & (vii) below	\$247 see notes (vi) & (vii) below
<b>Establishment of horticultural plants</b>	40-515	Nil see note (viii) below	Nil see note (viii) below	Nil see note (viii) below

**Notes:**

- (vi) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 124;
- (vii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);
- (viii) Mango trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the mango trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the mango trees have an 'effective life' of 30 years or more for the purposes of section 40-545, this results in a straight line write-off at a rate of 7%. The deduction is allowable when the mango trees enter their first commercial season (section 40-530, item 2). The

Manager will inform Growers of when the mango trees enter their first commercial season.

## **Tax outcomes for Growers who are ‘STS taxpayers’**

### **Assessable Income**

#### ***Section 6-5***

59. That part of the gross sales proceeds from the Project attributable to the Grower’s produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

60. The Grower recognises ordinary income from carrying on the business of agro-forestry at the time that income is received (paragraph 328-105(1)(a)).

### **Treatment of trading stock**

#### ***Section 328-285***

61. A Grower who is an ‘STS taxpayer’ may, in some years, hold mangoes that will constitute trading stock on hand. Where, for such a Grower, for an income year, the difference between the value of all their trading stock at the start and a reasonable estimate of it at the end, is less than \$5,000, they do not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

62. Alternatively, a Grower who is an ‘STS taxpayer’ may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

### **Deductions for Management fees and Lease fees**

#### ***Section 8-1 and section 328-105***

63. A Grower who is an ‘STS taxpayer’ may claim tax deductions under section 8-1 of the ITAA 1997, for the revenue expenses in the following Tables. Deductions will be available for 2002 Growers and 2003 Growers in accordance with the year in which the Grower commences participation in the Project.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Initial Period</b>	<b>Year 2</b>	<b>Year 3</b>
<b>Management Fees</b>	8-1 & 328-105	\$3,850  See note (ix) below	\$962.50  See notes (ix) & (x) below	\$962.50 (indexed) See notes (ix), (x) & (xii) below
<b>Planting</b>	8-1 & 328-105	See notes (ix) & (xiii) below	See notes (ix) & (xiii) below	
<b>Sub-Lease Fee (Rent)</b>	8-1 & 328-105	See notes (ix) & (xi) below	See notes (ix) & (xi) below	See notes (ix), (xi) & (xii) below

**Notes:**

- (ix) If the Grower is registered or required to be registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 124;
- (x) The Management fees shown in the Management Agreement are deductible in full in the year that they are incurred. However, if a Grower **chooses** to prepay fees for the doing of a thing (e.g., the provision of management services or the leasing of land) that will not be wholly done in the income year the fees are incurred, the prepayment rules of the ITAA 1936 may apply to apportion those fees. In such cases, the tax deduction for the prepaid fee **must** be determined using the formula shown in paragraph 51 unless the expenditure is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and, for a Grower who is not an 'STS taxpayer', is deductible in full in the year in which it is incurred (see Example 3 at paragraph 126). For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000;
- (xi) Although the Sub-Lease Agreement requires the lease fee to be prepaid, for a Grower who acquires the minimum allocation of one Woodlot, the amount of the prepaid lease fee is less than \$1,000 and will be deductible as 'excluded expenditure'. However, where a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's prepaid lease fee may be \$1,000 or more. Such Growers **must**

determine the deduction for the prepaid lease fee using the formula shown above at paragraph 51;

- (xii) Sub-Lease and management fees are subject to indexation. The amount will be the prior year fee indexed at 3% or the annual rate of inflation, whichever is greater;
- (xiii) Although the Management Agreement requires the Planting fee to be prepaid, for a Grower who acquires either one or two Woodlots, the amount of the prepaid fee is less than \$1,000 and will be deductible as 'excluded expenditure'. However, where a Grower acquires three or more Woodlots, the amount of the tax deduction for the Grower's prepaid Planting fee **must** be determined using the formula shown above at paragraph 51.

### **Deductions for capital expenditure**

#### ***Subdivision 40-F and Subdivision 328-D***

64. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (irrigation) and the establishment of mango trees. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40-F. If the 'water facility' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the mango trees must be determined under Subdivision 40-F.

65. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to, or can only claim deductions for expenditure on water facilities under Subdivision 40-F and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Note (xv) below.

66. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

67. Deductions will be available for 2002 Growers and 2003 Growers in accordance with the year in which the Grower commences participation in the Project.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Initial Period</b>	<b>Year 2</b>	<b>Year 3</b>
<b>Irrigation</b>	40-515	\$247 see notes (xiv) & (xv) below	\$247 see notes (xiv) & (xv) below	\$247 see notes (xiv) & (xv) below
<b>Establishment of horticultural plants</b>	40-515	Nil see note (xvi) below	Nil see note (xvi) below	Nil see note (xvi) below

**Notes:**

- (xiv) If the Grower is registered or required to registered for GST, amounts of outgoing would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 124;
- (xv) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the Initial Period is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the

year in which it is incurred and one third in each of the next 2 years of income (section 40-540);

- (xvi) Mango trees are a 'horticultural plant' as defined in subsection 40-525(2). As Growers hold the land under a sub-lease, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the mango trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. If the mango trees have an 'effective life' of 30 years or more for the purposes of section 40-545, this results in a straight line write-off at a rate of 7%. The deduction is allowable when the mango trees enter their first commercial season (section 40-530, item 2). The Manager will inform Growers of when the mango trees enter their first commercial season.

## **Tax outcomes that apply to all Growers**

### **Interest**

68. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 92 to 99 (below) as those rules may be applicable if interest is prepaid. Subject to the 'excluded expenditure' exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Growers choice.

## **Division 35 - deferral of losses from non-commercial business activities**

### ***Section 35-55 – Commissioner's discretion***

69. For a Non-Electing Grower who is an individual and who enters the Project during the years ended 30 June 2002 or 30 June 2003, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2002 to 30 June 2007 that the rule in section 35-10 does not apply to this activity, provided that the Project is carried out in the manner described in this Ruling (see paragraph 118).

70. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the ‘exception’ in subsection 35-10(4) applies; or
- a Grower’s business activity satisfies one of the tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

71. Where the ‘exception’ in subsection 35-10(4) applies, or the Grower’s business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of the deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

72. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner’s decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

### **Section 82KL and Part IVA**

73. For a Grower who participates in the Project and incurs expenditure as required by the Sub-Lease Agreement and the Management Agreement the following provisions of the ITAA 1936 have application as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.



---

## Explanations

---

### **Is the Grower carrying on a business?**

74. For the amounts set out in the Tables above to constitute allowable deductions the Grower's activities as a participant in the Sandalwood and Mango Project 2002, must amount to the carrying on of a business of primary production.

75. Where there is a business, or a future business, the gross proceeds from the sale of fruit and timber from the scheme will constitute assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income.

76. For schemes such as that of the Sandalwood and Mango Project 2002, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

77. Generally, an investor will be carrying on a business of agro-forestry, and hence primary production, if:

- the Grower has an identifiable interest (by lease or licence) in the land on which the Grower's trees are established;
- the Grower has a right to harvest and sell the fruit and timber from those trees;
- the agro-forestry activities are carried out on the Grower's behalf;
- the agro-forestry activities of the Grower are typical of those associated with an agro-forestry business; and
- the weight and influence of general indicators point to the carrying on of a business.

78. In this Project each Grower enters into a Sub-Lease Agreement and a Management Agreement.

79. Under the Sub-Lease Agreement each individual Grower will have rights over a specific and identifiable area of at least 0.1125 hectares of land. The Agreement provides the Grower with an ongoing interest in the specific trees on the leased area for the term of the Project. Under the lease the Grower must use the land in question for the purpose of carrying out agro-forestry activities, and for no

other purpose. The Agreement allows the Manager to come onto to the land to carry out its obligations.

80. Under the Management Agreement the Manager is engaged by the Grower to establish and maintain the Grower's identifiable area of land during the term of the Project. The Manager has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the leased area on the Grower behalf.

81. The Manager may also be engaged to harvest and sell, on the Grower behalf, the fruit and timber grown on the Grower's leased area.

82. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

83. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of fruit and timber that will return a before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

84. The pooling of produce grown on the Grower's leased area with the produce of other Growers is consistent with general agro-forestry practices. Each Grower's proportionate share of the sale proceeds of the pooled produce will reflect the proportion of the trees contributed from their leased area.

85. The Manager's services are also consistent with general agro-forestry practices. They are of the type ordinarily found in agro-forestry ventures that would commonly be said to be businesses. While the size of a Woodlot is relatively small, it is of a size and scale to allow it to be commercially viable. (See Taxation Ruling IT 360).

86. The Grower's degree of control over the Manager as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's leased area and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Manager in certain instances, such as cases of default or neglect.

87. The agro-forestry activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Grower's agro-forestry activities in the Sandalwood and Mango Project 2002 will constitute the carrying on of a business.

## **The Simplified Tax System**

### ***Division 328***

88. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

89. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

## **Deductibility of lease and management fees**

### ***Section 8-1***

90. Consideration of whether the lease and management fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

91. The management fees and lease fees associated with the agro-forestry activities will relate to the gaining of income from the Grower's business of agro-forestry (see above), and hence have a sufficient connection to the operations by which income (from the harvesting and sale of fruit and timber) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fees appears to be reasonable. There is no capital component of the management fee.

The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Prepayments provisions**

#### ***Sections 82KZL to 82KZMF***

92. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

93. For this Project only section 82KZL (an interpretive provision) and sections 82KZME and 82KZMF are relevant. Where the requirements of sections 82KZME and 82KZMF are met, taxpayers determine deductions for prepaid expenditure under section 82KZMF using the formula in subsection 82KZMF(1). These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF.

#### ***Sections 82KZME and 82KZMF***

94. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see paragraph 98 below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

95. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year; and
- the taxpayer does not have effective day to day control over the operation of the agreement. That is, the

significant aspects of the arrangement are managed by someone other than the taxpayer; and

- either :
  - a) there is more than one participant in the agreement in the same capacity as the taxpayer; or
  - b) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

96. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

97. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

98. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure. Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

99. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means, the period during which the thing under the agreement is to be done. The eligible service period begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

***Application of the prepayment provisions to this Project******Management fees***

100. Under the Management Agreement, the Management fee of \$3,850 is for things to be done by 30 June in the year in which the amount is incurred. Under the Agreement, further annual expenditure is required each year during the term of the Project for the provision of management services until 30 June in those years. In these circumstances, the prepayment provisions in sections 82KZME and 82KZMF have no application to these fees.

101. However, where a Grower chooses to prepay these fees for a period beyond the income year in which the expenditure is incurred, the prepayment provisions (see paragraphs 92 to 99) will apply to determine the amount and timing of the deductions regardless of whether the Grower is an 'STS taxpayer' or not. These provisions apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes 'STS taxpayers' from the operation of section 82KZMF. This is subject to the 'excluded expenditure' exception. For the purpose of this Ruling 'excluded expenditure' refers to an amount of expenditure of less than \$1,000.

***Planting and Sub-Lease Fees***

102. The expenditure incurred by a Grower in the Project for Planting fees and sub-lease fees meets the requirements of subsections 82KZME (1) and (2) and is incurred under an 'agreement' as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies, the amount and timing of tax deductions for those fees are determined under section 82KZMF.

103. The prepaid Planting and sub-lease fees incurred by Growers do not fall within any of the 5 exceptions to section 82KZME. Therefore, the deduction for each year is determined using the formula in subsection 82KZMF(1). Section 82KZMF will apportion the deduction for prepaid Management fees over the period that the services for which the prepayment is made are provided.

104. The prepaid fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is specifically excluded from the operation of section 82KZMF. A Grower who is an 'STS taxpayer' can, therefore, claim an immediate deduction for the fees in the income year in which they are paid. A Grower who is not an 'STS taxpayer' can claim an immediate deduction for the fees in the income year in which they are incurred.

105. However, where a Grower acquires more than the minimum allocation of one Woodlot in the Project and the quantum of the prepaid Planting or sub-lease fees is \$1,000 or more, the deduction allowable for those amounts will also be subject to apportionment according to the formula in subsection 82KZMF(1).

### **Expenditure of a capital nature**

#### ***Division 40 and Division 328***

106. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to water facilities and the establishment of the mango trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

107. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

108. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 58 and 67 (above) in the Tables and the accompanying Notes.

### **Division 35 - deferral of losses from non-commercial business activities**

109. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from certain business activities will not be taken into account in an income year unless:

- the 'exception' in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

110. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

111. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent

of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

112. For the purposes of applying the tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project, they are beyond the scope of this Product Ruling and are not considered further.

113. In broad terms, the tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets (excluding cars, motor cycles and similar vehicles) are used on a continuing basis in carrying on the business activity in that year (section 35-45).

114. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Non-Electing Grower who acquires the minimum investment in the Project of one Woodlot during the years ended 30 June 2002 or 30 June 2003, is unlikely to pass one of the tests until the year ended 30 June 2010.

115. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

116. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on; and



- (ii) because of its nature, it has not yet met one of the tests set out in Division 35; and
- (iii) there is an expectation that the business activity of an individual taxpayer will either pass one of the tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

117. Information provided with this Product Ruling indicates that a Non-Electing Grower who acquires the minimum investment of one Woodlot in the Project is expected to be carrying on a business activity that will either pass one of the tests, or produce a taxation profit, for the year ended 30 June 2008. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion until the year ended 30 June 2007. Subsection 35-55(2) prevents the Commissioner exercising the discretion beyond this year.

118. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). However, the Project may fail to be carried on during the income years specified above (see paragraph 69) in the manner described in the Arrangement (see paragraphs 15 to 44). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no longer applies (see paragraph 9) the Commissioner's discretion will not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

119. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the Independent Agro-Forester, and additional evidence provided with the application by the Manager; and
- independent, objective and generally available information relating to the Mango and Sandalwood industries which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

## **Section 82KL**

120. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the

application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

#### **Part IVA**

121. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

122. The Sandalwood and Mango Project 2002 will be a 'scheme' commencing with the issue of the Prospectus. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 57 to 67 that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

123. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual harvesting of the trees. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There are no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

## **Examples**

### **Example 1 - Entitlement to GST input tax credits**

124. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002	\$4,400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2,200*</u>

Total due and payable by 1 January 2002 \$6,600  
(includes GST of \$600)

\*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$\frac{1}{11} \times \$4,400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4,400 *less* \$400, or \$4,000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$\frac{1}{11} \times \$2,200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2,200 *less* \$200, or \$2,000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4,000 (not \$4,400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2,000 only, not one tenth of \$2,200).

### **Example 2 – prepaid expenditure and the apportionment of fees**

125. Ray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and, thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Ray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Ray that the minimum subscription has been reached and the Project will go ahead. Ray's agreements are duly executed and management services start to be provided on that date.

Ray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

Management fee x  $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Ray's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000 and represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Ray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Ray in the 2002 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Ray in the 2002 income year).

**\$4,643 + \$85 = \$4,728** (The sum of these two amounts is Ray's total tax deduction for management fees in 2002).

Ray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

### **Example 3 – apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'**

126. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

*Management fee*

Even though he paid the \$3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

*Lease fee*

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\$3,600 \times \frac{365}{365}$$

= **\$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

## **Detailed contents list**

127. Below is a detailed contents list for this Product Ruling:

	<b>Paragraph</b>
<b>What this Product Ruling is about</b>	<b>1</b>
Tax laws	2
Goods and Services Tax	3
Changes in the Law	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Previous Ruling</b>	<b>14</b>
<b>Arrangement</b>	<b>15</b>

Overview	17
Constitution	23
Compliance Plan	25
Head Lease	26
Interest in land	27
Management Agreement	29
Fees	31
Planting	35
Harvesting and Sale	36
Finance	43
<b>Ruling</b>	<b>45</b>
Application of this Ruling	45
Minimum subscription	47
The Simplified Tax System ('STS')	48
Division 328	48
Qualification	49
Prepaid fees	50
Tax outcomes for Growers who are not 'STS taxpayers'	53
Assessable income	53
<i>Section 6-5</i>	53
Trading Stock	55
<i>Section 70-35</i>	55
Deductions for management fees and lease fees	57
<i>Section 8-1</i>	57
Deductions for capital expenditure	58
<i>Division 40</i>	58
Tax outcomes for Growers who are 'STS taxpayers'	59
Assessable Income	59
<i>Section 6-5</i>	59
Treatment of Trading Stock	61
<i>Section 328-285</i>	61
Deductions for management fees and lease fees	63
<i>Section 8-1 and section 328-105</i>	63

Deductions for capital expenditure	64
<i>Subdivision 40-F and Subdivision 328-D</i>	64
Tax outcomes that apply to all Growers	68
Interest	68
Division 35 - deferral of losses from non-commercial business activities	69
<i>Section 35-55 – Commissioner’s discretion</i>	69
Section 82KL and Part IVA	73
<b>Explanations</b>	<b>74</b>
Is the Grower carrying on a business	74
The Simplified Tax System	88
<i>Division 328</i>	88
Deductibility of lease and management fees	90
<i>Section 8-1</i>	90
Prepayments provisions	92
<i>Sections 82KZL to 82KZMF</i>	92
<i>Sections 82KZME to 82KZMF</i>	94
<i>Application of the prepayment provisions to this Project</i>	100
<i>Management Fees</i>	100
<i>Planting and Sub-Lease fees</i>	102
Expenditure of a capital nature	106
<i>Division 40 and Division 328</i>	106
Division 35 - deferral of losses from non-commercial business activities	109
Section 82KL	120
Part IVA	121
<b>Examples</b>	<b>124</b>
Example 1 - entitlement to GST input tax credits	<b>124</b>
Example 2 - prepaid expenditure and the apportionment of fees	125
Example 3 - apportionment of fees where there is a contractual ‘eligible service period’ and the fees include expenditure that is ‘excluded expenditure’	126
<b>Detailed contents list</b>	<b>127</b>

**Commissioner of Taxation**

6 February 2002

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

PR 1999/95; PR 2001/79; TR 92/1;  
 TR 92/20; TR 97/11; TR 97/16;  
 TR 98/22; TR 2000/8; TD 93/34;  
 IT 360

*Subject references:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees
- producing assessable income
- product rulings
- public rulings
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

*Legislative references:*

- ITAA 1936 82KL
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZME
- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(7)
- ITAA 1936 82KZMF
- ITAA 1936 82KZMF(1)
- ITAA 1936 Div 3 of Part III
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177D(b)
- ITAA 1997 Part 2-25
- ITAA 1997 6-5

- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- ITAA 1997 Div 35
- ITAA 1997 35-10
- ITAA 1997 35-10(2)
- ITAA 1997 35-10(3)
- ITAA 1997 35-10(4)
- ITAA 1997 35-30
- ITAA 1997 35-35
- ITAA 1997 35-40
- ITAA 1997 35-45
- ITAA 1997 35-55
- ITAA 1997 35-55(1)
- ITAA 1997 35-55(1)(a)
- ITAA 1997 35-55(1)(b)
- ITAA 1997 35-55(2)
- ITAA 1997 Div 40
- ITAA 1997 Subdiv 40-F
- ITAA 1997 40-515
- ITAA 1997 40-515(1)(a)
- ITAA 1997 40-515(1)(b)
- ITAA 1997 40-520(1)
- ITAA 1997 40-525(2)
- ITAA 1997 40-530
- ITAA 1997 40-540
- ITAA 1997 40-545
- ITAA 1997 Div 70
- ITAA 1997 70-35
- ITAA 1997 Div 328
- ITAA 1997 328-105
- ITAA 1997 328-105(1)(a)
- ITAA 1997 328-285
- ITAA 1997 328-285(1)
- ITAA 1997 328-285(2)
- ITAA 1997 Subdiv 328-D
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G

*Case references:*

- FCT v. Lau 84 ATC 4929

ATO references:

NO: T2002/001453

ISSN: 1441-1172